No. 328

In the Supreme Court of the United States

OCTOBER TERM, 1938.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, *Petitioner*,

v.

R. J. REYNOLDS TOBACCO COMPANY.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

BRIEF FOR RESPONDENT IN OPPOSITION.

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September, 1938.

INDEX.

CITATIONS.

Cases:

Legal and Accounting Textbook Authorities:

Statutes:

Regulations and Treasury Department Rulings:

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OPINIONS BELOW.

The opinion of the Board of Tax Appeals (R. 21) is reported in 35 B. T. A. 949. The opinion of the Circuit Court of Appeals (R. 108), reversing the Board, is reported in 97 F. (2d) 302. The judgment of the Circuit Court of Appeals was entered June 6, 1938 (R. 116).

QUESTION PRESENTED.

The question here presented is not the abstract question of whether this case is governed by the provisions of one regulation or another.

The question is whether a tenable statutory construction applied for approximately 25 years with the repeated affirmation of Regulations, Decisions and Rulings of the Department, by Board and Court decisions, and by repeated reenactments of the statute, has the force and effect of law; and whether the Court below correctly decided that, under those circumstances, and under the

rule of this Court, such statutory construction should not be overthrown.

It is respectfully submitted that a mere reading of the instant petition does not clearly convey that the Commissioner is asking that a construction placed upon a statutory definition (general in its terms) by the Treasury Department and applied over a period of approximately 25 years, shall be held invalid, void, untenable, and unsupportable on any reasonable basis.

The Court below found and held that the said long continued construction has a reasonable basis to support it, and that it has the support of numerous Board decisions, court decisions, and text authorities. The Court below also found and held that a different construction would likewise be tenable. Under these circumstances the Court below applied the rule laid down by this Court to govern such cases, and sustained the long continued construction placed upon the statute by the Treasury Department. The Court below further held that since the departmental construction had for many years received the affirmation of the Board of Tax Appeals and of the Courts, and had received the sanction of Congress in five successive carefully considered revenue acts, such construction is controlling under the circumstances of this case.

The question therefore is whether the Court below was correct in following the rule of this Court applicable in such circumstances.

HOW THE ISSUE AROSE.

This was a petition to the Circuit Court of Appeals for the Fourth Circuit to review an order of the Board of Tax Appeals finding a deficiency in income tax for the year 1929, in the amount of $37,865.62. The issue arose in this way:

The Commissioner determined a deficiency on a transaction totally unrelated to the transaction here in question, and mailed deficiency notice on April 3, 1933. He did not determine that the instant transaction was taxable and

made no determination of deficiency relative thereto. Taxpayer filed petition in the Board of Tax Appeals on May 4, 1933. Answer was filed on June 27, 1933. Thereafter the cause was at issue for approximately three years, during which time the parties worked out an agreement and settlement of the only issue in the case. Then, on February 15, 1936, the Commissioner filed an amended answer in which he pleaded in effect that the Regulations in force and effect in 1929, and under which taxpayer had made the instant transaction, were erroneous and that the taxpayer had realized taxable income from said instant transactions in 1929. Taxpayer filed reply to said amended answer on March 14, 1936, and pleaded that the transactions in question had been made under and pursuant to the provisions of the Revenue Act of 1928, and the Regulations duly promulgated thereunder, and that the construction placed upon the statute by Departmental Regulations, Decisions and Rulings, and by Board and Court decisions, had continued for many years, and that during that period the revenue act had been repeatedly reenacted without change. Taxpayer pleaded the rule of this Court applicable under such circumstances as a complete bar to recovery of an additional deficiency arising by reason of the instant transactions. The petitioner further pleaded that the said construction was a sound construction and that the transactions in question were not taxable.

The Board found for the Commissioner. The taxpayer sought review in the Circuit Court of Appeals for the Fourth Circuit. That Court reversed the Board and held that the case is governed by the doctrine and rule of this Court that if a statute is reasonably susceptible of two constructions, its reenactment, after a construction by responsible officials has been long maintained, amounts to a legislative sanction of that construction.

STATEMENT.

The facts, substantially as found by the Board of Tax Appeals (R. 22–30) are set out in the instant petition and need not be fully restated here. The facts as found by the Court below are set out at R. 109–112. The facts are not in dispute.[1] They may be summarized as follows:

Taxpayer corporation had issued its stock for cash. Thereafter it reacquired certain shares of its own stock for cash. Such acquisition was not pursuant to any contract agreement. Such stock was later reissued for cash, to persons desiring to acquire stock of the company. The original certificates were cancelled and new certificates issued.

The acquisition and reissue of such stock was effected for the purpose of protecting and preserving (1) the reputation of the company, (2) the reputation of the company's products and brands, and (3) the reputation of the company's stock. Each such transaction was made by the company under conditions which necessitated such action and under the necessity of protecting the company's business from a threatened peril (R. mid. 26, mid. 27, mid. 81, 82, top 83, top 84, mid. 86). The company acquired none of this stock as a medium of payment in any transaction in which the company sold an asset or a commodity (R. top 92). The company's charter did not authorize it to deal in stocks of any kind. The company did not believe that these transactions constituted dealing in stock (R. mid. 88). The company has never dealt in corporate shares (R. mid. 91). The sole purpose in the instant transactions was to protect the company and its business in a special situation (R. top 88, mid. 90, mid. 86). The reissuance of the stock here involved occurred in 1929. Some of the stock so reissued in 1929 had been acquired by the company in 1921 and

[1] Taxpayer would, however, call attention to a minor error occurring in the first line of page 10 of the petition herein, and in the 2d paragraph of R. 27, where the date mentioned should read "September 18, 1929," instead of "December 18, 1929." See Record near top page 85.

had been held by the company as treasury stock since that time. The remaining shares so reissued had been acquired earlier in the year 1929 (R. 110–111).

The company made said transactions in view of departmental regulations, rulings and decisions, then in force and effect, and in the belief that the departmental regulations were correct and controlling (R. 29, 111, bot. 80).

Under the Revenue Act of 1918, the Department promulgated Regulations 45, Art. 542, holding that where a corporation acquires stock previously issued by it, the sale of such stock constitutes a capital transaction and the proceeds of such sale constitutes capital and not income of the corporation, and that a corporation realizes no gain or loss from the purchase or sale of its own stock. That construction was applied by Departmental Rulings to all prior Revenue Acts (the Revenue Acts of 1913 and 1916) and to the Corporation Tax Act of 1909.

That Regulation was continued without change down to 1934. During that period the Department issued many rulings and decisions supporting and reaffirming that regulation. The Commissioner repeatedly defended that regulation before the Board of Tax Appeals. The Board repeatedly affirmed it by published decisions. The Regulation received the approval of the Circuit Courts of Appeals.

In 1929 these regulations, rulings and decisions were in force and effect and were at that time being continuously applied and vigorously defended by the Department,[1] and in 1929 the taxpayer made its transactions. A more detailed chronology of the history of the long continued construction will be set forth hereinafter.

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[1] In his brief filed in the Board in 1926, in *Emerson Electric Co.*, 3 B. T. A. 932, the Commissioner cited and quoted Art. 542 of Reg. 45 and argued (as he had done in all the previous cases) that the Regulation was not contrary to the intent and purpose of the Revenue Act's definition of income, but that it was fully in accord therewith; and then said: "*This regulation has been applied and followed for so long as to become stare decisis under the principle announced by the Supreme Court in the Flannery case.*

In 1934, the Department issued *Treasury Decision 4430*, C. B. XIII–1, 36. That was after the established rule had been applied for about 25 years, by rulings and decisions of the Department and about 16 years after it had remained continuously in the Regulations, and about 5 years after the taxpayer had made its instant transactions. The effect of *Treasury Decision 4430* was to declare invalid and of no effect all the Regulations, Rulings and Decisions above referred to. The Commissioner invoked this new ruling in the instant case some 3 years after the instant cause was at issue in the Board.

In the instant case the position of the Commissioner is that: (1) the long continued regulations, rulings and decisions of the Bureau, the Board, and the Courts, are null and void and of no effect, (2) that they are and have always been plainly and obviously wrong and untenable and without any reason to support them, (3) that the repeated reenactments of the statute, without change, give no support to them, and (4) that they were invalid and void in 1929 and in all the years during which they were in effect and while they were being enforced by the Department.

STATUTES AND OTHER AUTHORITIES INVOLVED.

These are printed in the Appendix, *infra*, pp. 24–26.

ARGUMENT.

It is submitted that the Court below correctly applied the rule, under the well established doctrine of this Court, that when a statute is reasonably susceptible of two constructions, its repeated reenactment in light of an interpretative ruling by responsible officials, amounts to a legislative sanction of the course pursued, and especially when the construction has been long maintained and several reenactments of the statutory language have taken place (R. 115). The Court below was correct in reversing the Board.

1. *The Decision of the Court Below Does Not Sustain a Contention which Exempts Income from Taxation.*

The decision below does not purport to uphold an exemption from taxation, as suggested by the instant petition (Pet. 17–18). The decision is specifically grounded on the proposition that there is reason and authority to support the long continued construction put upon the statute, and that accordingly the duty of the Court was clear in applying literally the mandate of this Court applicable under the circumstances.

The long continued rule of construction was that in transactions of this kind no income could or did accrue to the corporation,[1] and that the sale by a corporation of its own reacquired stock constitutes a capital transaction and the proceeds of such sale do not constitute income because a corporation realizes no gain or loss on the purchase or sale of its own stock.[2] It is thus apparent that the long continued construction is not one which *exempts* a taxpayer's gain from taxation.

2. *The Decision of the Court Below is Correct.*

It should first be clearly understood exactly what the Court below decided. It decided only that, as between two reasonable constructions of the statute, that construction which has received long and continuous application by responsible officials, and in light of which several reenactments of the statute have taken place, must be held to have received legislative sanction.

Three main elements appear in the decision: (1) the duration of the construction, (2) the presence of reason to support it, and (3) the repeated reenactments of the statute, without change, during the continuance of that construction.

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[1] *Law Opinion 296*, 5 C. B. top 210, issued under the 1913 Act; A. R. R. 693, 5 C. B. 207, bot. 209.

[2] Reg. 45, Art. 542; Reg. 62, Art. 543; Reg. 65, Art. 543; Reg. 69, Art. 543; Reg. 74, Art. 66; Reg. 77, Art. 66.

The history and long duration of the construction will be set forth in chronological form showing its long continued application. That there is authority and reason to support it is shown by the numerous decisions rendered in support of it, over a long period of years, by many responsible departmental officials, by the Board of Tax Appeals, and by the Courts. The reenactments of the revenue act speak for themselves. The history of the construction, the support it has had in many considered opinions and decisions, and the reenactments of the statute will be here briefly, but by no means exhaustively, reviewed.

Very early in the history of income taxation the construction of the general statutory definition of income, as applied to transactions of the kind here involved, came under consideration by the departmental officials charged with the duty of administering the statute and promulgating regulations pursuant thereto. The then outstanding authorities on the subject were in general agreement that reacquired, or treasury, stock was not property, or a commodity, in the hands of the issuing corporation; that the issue of such stock has the same effect as the original issue of such stock; and that the issuance of such stock was a capital issue and constituted a capital transaction resulting in neither gain nor loss. Among such authorities were the many text writers on the subject whose views were to the same effect and have, without substantial variance, prevailed from that day down to the present.

Among such authorities are the following:

Esquerre, "*Applied Theory of Accounts.*" (See 2 C. B. 211.)

Dickinson, "*Accounting Practice & Procedure,*" 130, 132.

Paton, "*Accountants' Hand Book.* 931–2, 980–1.

Wildman and Powell, "*Capital Stock Without Par Value,*" 93–4.

Sunley and Pinkerton, "*Corporation Accounting,*" 121.

Kester, "*Accounting Theory and Practice,*" 17.

Esquerre, "*Practical Accounting Problems*," Part II, 1922, 6–81.

Hills, "*Stated Capital and Treasury Shares*," Journal of Accountancy, Vol. 57, Jan. to June, 1934, 202, 212, 213.

Marple, "*Treasury Stock*," Journal of Accountancy, Vol. 57, Jan. to June, 1934, 257, 262–3.

Holmes, "*Federal Taxes*," (6th Ed.) p. 236.

Moravetz on Private Corporations (2d Ed.), Vol. 1, sec. 112, p. 109.

The Treasury Department gave careful consideration to this question in light of existing authorities, and ruled that if a corporation reacquires shares of its own stock previously issued by it, and later sells and reissues such stock, such sale constitutes a capital transaction and the proceeds of the sale constitute capital and not income to the corporation.[1] This construction was later adopted as a departmental *Regulation* with the approval of the Secretary (Regulations 45, Art. 542, promulgated under the Revenue Act of 1918). Soon thereafter, the Department promulgated *Law Opinion 1035*, 2 C. B. 132, approving the rule and stating that it applied with equal force to the Revenue Act of 1916 and to the Corporation Tax Act of 1909. Soon after that the Department promulgated ruling *A. R. R. 693*, 5 C. B. 207, 209, stating that the provisions of the Regulation applied to revenue acts prior to the Revenue Act of 1918.

From that time forward, and down to 1934, the above principles were affirmed and reaffirmed year after year, by repeated Departmental Rulings and by continuous inclusion in the Departmental Regulations promulgated under each succeeding Revenue Act—each Revenue Act being reenacted in light of such continued construction, and in each instance without change. The chronology of these Departmental Rulings and Regulations is as follows:

[1] The statement of the principle is clearly and concisely summarized by Judge Learned Hand in *Borg* v. *International Silver Co.*, 11 F. (2d) 147, 150, as set forth in Appendix, pages 27, 28.

Law Opinion 296, 5 C. B. top p. 210.[1]
Law Opinion 426, 5 C. B. mid. p. 210.[2]
1919 *Revenue Act of 1918.*
1920 *Treasury Regulations 45, Art. 542 and 563*, pursuant to 1918 Act.
1920 *Law Opinion 1035*, 2 C. B. 132.
1920 *Law Opinion 1035* (Revised), 3 C. B. 160, 162.
1921 *Treasury Decision 3206*, 23 T. D. 763.
1921 *A. R. R. 693*, 5 C. B. 207.
1921 *Revenue Act of 1921.*
1922 *Treasury Decision 3295*, 24 T. D. 207, promulgating *Treasury Regulations 62, Art. 543 and 563*, pursuant to 1921 Act.
1922 *I. T. 1198*, C. B. I–1, 275.
1922 *A. R. R. 799*, C. B. I–1, 374.
1923 *I. T. 1736*, C. B. II–2, 274.
1923 *I. T. 1802*, C. B. II–2, 267.
1924 *Revenue Act of 1924.*
1924 *Treasury Decision 3640*, 26 T. D. 745, promulgating *Treasury Regulations 65, Art. 543 and 563*, pursuant to 1924 Act.
1924 *S. M. 2205*, C. B. III–2, 244.
1924 *A. R. R. 8159*, C. B. III–2, 256.
1926 *Revenue Act of 1926.*
1926 *Treasury Regulations 69, Art. 543 and 563*, pursuant to 1926 Act.
1928 *Revenue Act of 1928.*
1928 *Treasury Regulations 74, Arts. 66 and 176*, pursuant to 1928 Act.
1932 *Revenue Act of 1932.*
1932 *Treasury Regulations 77, Art. 66 and 176*, pursuant to 1932 Act.
1934 *Revenue Act of 1934.*

From the foregoing it is seen that the rule was applied by

[1] The date of L. O. 296 is not given but it is stated that it was issued under the Revenue Act of 1913.

[2] The date of L. O. 426 is not given but it is stated that it was issued under the Revenue Act of 1916.

the Treasury Department through Rulings, Decisions and Regulations from 1909 down to and including the time of the passage of the Revenue Act of 1934—a period of approximately 25 years. During that long period of years the rule was made the subject of consideration, ruling, decision and affirmation by not less than seven Solicitors and General Counsels, six Commissioners of Internal Revenue, and five Secretaries of the Treasury.

In the meantime, however, the Board of Tax Appeals had come into existence in 1924. The Commissioner repeatedly argued before the Board in support of the Departmental construction,[1] and the Board repeatedly affirmed it. The Board held in *Simmons & Hammond Mfg. Co.*, 1 B. T. A. 803 (1925) that where a corporation sold shares of its own stock which it had previously reacquired, no loss occurred to the corporation. That decision was followed by the Board and applied under varying states of fact:

1925 *Simmons & Hammond Mfg. Co.*, 1 B. T. A. 803.
1925 *Cooperative Furniture Co.*, 2 B. T. A. 165.
1925 *Atlantic Carton Co.*, 2 B. T. A. 380.
1926 *Emerson Electric Co.*, 3 B. T. A. 932.[1]
1926 *Illinois Rural Credit Ass'n*, 3 B. T. A. 1178.
1926 *Hutchins Lumber & Storage Co.*, 4 B. T. A. 705.
1926 *Farmers Deposit National Bank*, 5 B. T. A. 520.
1926 *H. S. Crocker Co.*, 5 B. T. A. 537, 541.
1926. *Interurban Construction Co.*, 5 B. T. A. 529.
1926 *Liberty Agency Co.*, 5 B. T. A. 778.
1927 *Simmons Company*, 8 B. T. A. 631, 645; aff'd 33 F. (2d) 75 (CCA 1); cert. denied 280 U. S. 588.
1928 *Union Trust Co.*, 12 B. T. A. 688, 690.
1929 *105 West 55th Street, Inc.*, 15 B. T. A. 210, 213; aff'd 42 F. (2d) 849 (CCA 2).
1929 *Riggs National Bank*, 17 B. T. A. 615, 618; aff'd 57 F. (2d) 980 (CCA 4).

[1] See footnote, bot. p. 5, *supra*.

1930 *J. H. Johnson*, 19 B. T. A. 840, 847; aff'd 56 F. (2d) 58 (CCA 5); cert. denied 286 U. S. 551.

1930 *American Cigar Co.*, 21 B. T. A. 464, 495; aff'd 66 F. (2d) 425 (CCA 2); cert. denied 286 U. S. 551.

1930 *Inland Finance Co.*, 23 B. T. A. 199; aff'd 63 F. (2d) 886 (CCA 9).

1932 *Carter Hotel Co.*, 25 B. T. A. 933; aff'd 67 F. (2d) 642 (CCA 4).

Thus it is seen that the rule was being urged by the Department in the Board and in the Courts over a long period of years; and that contemporaneously with the Departmental Regulations, and in accordance with Departmental Regulations, Decisions and Rulings, the Board and the Courts, over this same period of years, were giving affirmation and approbation to the rule.

In the same year (1925) in which the Board decided *Simmons & Hammond Mfg. Co., supra*, the Second Circuit Court of Appeals decided *Borg* v. *International Silver Co.*, 11 F. (2d) 147, 150 (cited and quoted by the Court below at R. 113). In that decision the same rule and doctrine was upheld, viz., that transactions of this sort are capital and not income transactions.

The Seventh Circuit Court of Appeals in *Commissioner* v. *Van Camp Packing Co.*, 67 F. (2d) 596 (1933) stated that the rule is applicable in a case where the corporation acquires and sells shares of its own stock as distinguished from shares of another (and subsidiary) corporation.

It was in light of the above administrative and legislative history that the Court below made its decision. The Court found that two reasonable constructions might be put upon the section. The Court then followed literally the mandates of this Court that: "Possible doubts as to the proper construction of the language used should be resolved in the light of its administrative and legislative

history."[1] "If there were doubt as to the connotation of the term, and another meaning might be adopted, the fact of its use in a tax statute would incline the scale to the construction most favorable to the taxpayer."[2] "The Commissioner has heretofore administered the section upon this theory. * * * The repetition of the definition without material change in the subsequent acts, including that of 1928, amounts to a confirmation of the administrative interpretation. There is nothing in the section, its history, or the administrative practice, to enlarge or alter the connotation commonly ascribed to the word 'held.'"[3] "It is especially objectionable that a construction of a statute favorable to the individual citizen should be changed in such manner as to become retroactive * * *."[4] "* * * the reenactment by Congress, without change, of a statute which had previously received long-continued executive construction, is an adoption by Congress of such construction."[5] "These provisions were retained, without substantial change, in the regulations promulgated under the 1924, 1926 and 1928 Acts. * * * As §234 (a) (1) to which they pertain has been reenacted in several revenue acts, the regulation now has the force of law."[6] "This construction of those terms has been adhered to in the Internal Revenue Bureau for about ten years and it ought not to be disturbed now unless it be plainly wrong."[7]

The Court below applied each of the foregoing injunctions of this Court to the circumstances in this case and held that the long continued construction put upon the act was not null and void and without any reason to support it. The rationale of the Court below is thus stated (R. bot. 115):

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[1] *McCaughn* v. *Hershey Chocolate Co.*, 283 U. S. 488, 492.
[2] *Old Colony R. Co.* v. *Com'r*, 284 U. S. 552, 561.
[3] *McFeely* v. *Helvering*, 296 U. S. 102, 108.
[4] *United States* v. *Alabama Great Southern R. Co.*, 142 U. S. 615, 622.
[5] *United States* v. *Cerecido Hermanos y Compania*, 209 U. S. 337, 339.
[6] *Old Mission P. Cement Co.* v. *Helvering*, 293 U. S. 289, 293–294.
[7] *Universal Battery Co.* v. *United States*, 281 U. S. 580, bot. 583.

> Our path is therefore clear; for the rule is well settled that if a statute is reasonably susceptible of two constructions, its reenactment after an interpretative ruling by responsible officials amounts to a legislative sanction of the course pursued. Especially is this true when the construction has been long maintained and several reenactments of the language in dispute have taken place. The rule has been frequently applied in cases under the revenue acts when the statutory language is in general terms and susceptible of different interpretation as applied to the relevant facts; and in Johnson *v.* Commissioner, 56 F. (2d) 58, (C.C.A. 5) 1932, it was applied to the very regulation now under consideration as set out in Regulations 62, Article 543 relating to the Revenue Act of 1921.

As the basis for its said conclusion the Court found that for 16 years (1918 to 1934) the regulations and decisions of the Department, decisions of the Board, and decisions of the Courts supported the long continued construction, and that text writers have generally held to the same effect. The Court recited that neither interpretation of the act is without a reasonable basis, but that since the prevailing opinion had supported the construction for so many years, and that since, in light of such opinion, Congress had reenacted the definition in five successive carefully considered revenue acts, the long continued construction must be deemed to have legislative sanction.

The Court below was correct in following the established rule of this Court in such circumstances. That rule is set forth in the following cases:

United States v. *Alabama Great Southern R. Co.*, 142 U. S. 615.

United States v. *Finnell*, 185 U. S. 236.

Copper Queen Consol. Min. Co. v. *Arizona*, 206 U. S. 474.

United States v. *Cerecido Hermanos y Compania*, 209 U. S. 337.

National Lead Co. v. *United States*, 252 U. S. 140.

United States v. *Jackson*, 280 U. S. 183.
Brewster v. *Gage*, 280 U. S. 327.
Luckenbach Steamship Co. v. *United States*, 280 U. S. 173.
Universal Battery Co. v. *United States*, 281 U. S. 580.
Fawcus Machine Co. v. *United States*, 282 U. S. 375.
McCaughn v. *Hershey Chocolate Co.*, 283 U. S. 488.
Old Colony R. Co. v. *Commissioner*, 284 U. S. 552.
Murphy Oil Co. v. *Burnet*, 287 U. S. 299.
Massachusetts Mutual L. Ins. Co. v. *United States*, 288 U. S. 269.
Helvering v. *Bliss*, 293 U. S. 144.
Old Mission P. Cement Co. v. *Helvering*, 293 U. S. 289.
Hartley v. *Commissioner*, 295 U. S. 216.
McFeely v. *Helvering*, 296 U. S. 102.
Koshland v. *Helvering*, 298 U. S. 441.
Helvering v. *Minnesota Tea Co.*, 296 U. S. 378, 383–384.
Hassett v. *Welch*, —— U. S. ——, 82 L. ed. —— (Adv. Op. 575).

3. *There is No Real Conflict Below.*

The petition states that the decision below is in conflict with the decision in *First Chrold Corp.* v. *Commissioner*, 97 F. (2d) 22, and states that the Circuit Courts below reached conflicting *results* (Pet. mid. 16).

It is respectfully submitted that the alleged conflict is apparent and not real. The Third Circuit Court of Appeals approached the question by stating: "We treat the case as presenting but one question." The Court then stated the question to be whether or not a corporation realized a taxable profit when it acquired shares of its own stock and reissued them for a price above the acquisition price. The Court treated the case as one of first impression. The Court made no mention of the Regulations, existing since 1918, upon which the taxpayer relied in making its transaction. The Court made no

mention of the many Departmental Rulings and Decisions applying that regulation. The Court made no mention of the authorities, cases and decisions tending to show that there was reason, logic and authority to support that construction. The Court did not decide or hold that the old and long continued construction was clearly and obviously wrong and untenable.

That decision held only one thing. It held only that, viewed as a matter of first impression, shares of stock are *thought of* as property, because shares can be bought and sold; that a corporation may buy and sell its own shares as it does other kinds of property, in a *practical* sense; that in such case it ignores the fact that it is its own stock; that this is so because corporations are known to do it; that when a corporation buys and sells its own stock it constitutes an "as if" transaction, i. e., in such cases the corporation buys and sells them "*as if*" *they were not the corporation's own shares.* The Court concludes that this in no way affects the capital of the corporation because it is assumed that, if the shares were not the corporation's own shares, the transaction would be taxable, but since they *were* the corporation's own shares, they would, notwithstanding, be considered "as if" they *were not.* The Court cites no authority for its view. The Court, in effect, says that, as an abstract proposition of first impression, such a transaction ought to be taxed.

The *Fourth Circuit Court of Appeals* decides no such thing. The Court below says: "We do not undertake to say that the present regulations would not have been a correct interpretation of the statute, as applied to such facts as are now before us, if it had been promulgated in 1918." The Court below holds, in effect, that even though the Third Circuit's view be tenable, those views do not decide the instant issue because the long continued construction can not be overthrown and cast aside unless it be shown to be plainly wrong. The Third Circuit Court of Appeals did not find the long continued construction to be plainly wrong. It did not refer to it.

The two Circuit Courts are not in real conflict because they do not decide the same issue.

The Third Circuit Court of Appeals decided that a transaction was not a capital transaction but was a taxable sale of property; ignoring the administrative and legislative history showing that the opposite rule had become embedded in the statute. The Fourth Circuit Court of Appeals decided that the rule had become imbedded in the statute and that the question whether a similar transaction was a capital or an income transaction was not of controlling importance, albeit there was reason to support either view. The instant case was decided on the issue which is controlling under the circumstances. The Third Circuit Court of Appeals did not decide that issue. The Third Circuit Court decided that there is reason to support the contention that the transaction was an income and not a capital transaction. The Fourth Circuit Court did not deny that. The Fourth Circuit Court decided that there was likewise reason to support the long continued statutory construction. The Third Circuit Court made no decision as to that. The Fourth Circuit Court decided that under the circumstances the long continued statutory construction had the force and effect of law. The Third Circuit Court of Appeals did not discuss that issue.

The instant petition refers to the decision of the Second Circuit Court of Appeals in *E. R. Squibb & Sons* v. *Helvering*, 98 F. (2d) 69, as bearing upon the point of conflict. Respondent herein is advised by counsel that the Second Circuit Court of Appeals has granted rehearing, and that such rehearing has not yet been had.

What has been said above applies equally to the decisions in the *Squibb case, supra*, and in the *First Chrold case, supra*. This is so because the Second Circuit Court of Appeals based its decision on precisely the same grounds as those on which the Fourth Circuit Court of Appeals

based its decision in the instant case. The Second Circuit Court stated: "But in any event it seems to us that the uniform interpretation, so long placed upon §22(a), 26 U. S. C. A. §22(a), by the regulations and confirmed by the inaction of Congress, was imbedded in the statute so deep that only legislation could dislodge it." The Court stated that it is unnecessary to say that no other interpretation could have been made. The Court discussed arguendo the corollary question of abstract taxability of the transaction and concluded that snares acquired and sold by the issuing corporation, for cash, at the market, are capital transactions. However, a reading of the decision shows that the *basis of the Court's decision* is the Supreme Court's rule applicable to the long continued construction of the statute. Thus it appears clear that the *Squibb case* decided an issue which was not discussed in the *First Chrold case*.

The instant petition makes reference (p. 20) to a number of cases which have no relevancy here. In each and every one of these cases the taxpayer sold a physical asset—in one instance the sale was of a building in the city of Dallas; in another case it was "an ordinary sale of property"; in another it was the sale of an account receivable. In no one of those cases was there a sale of stock involved. In each case the sale of the asset was made at a taxable profit. Those cases held that such profit was not to be exempted from tax merely because the selling corporation accepted shares of its own stock as a medium, or partial medium, of payment.

4. *The Instant Case Presents No Exception to the Established Rule of This Court.*

Sec. 22 (a) of the 1928 Act is a *general definition* of income. It is not proper to classify it as "ambiguous" or as "unambiguous." As in all such general statutory definitions it is the duty of the Department to indicate the method of its application to specific cases. This Court has

said that "where the statute merely expresses a general rule and invests the Secretary of the Treasury with authority to promulgate regulations," "a clarifying regulation or one indicating the method of its application to specific cases" will be given great weight by the courts.[1] This Court has also said that where the Department has long continued to administer a general definition by specific construction, such construction must not be altered unless the section, its history, and the administrative practice, shows it to be violative of the plain and unequivocal meaning of the statute.[2] This Court has held that possible doubts as to such construction must be reviewed in the light of its administrative and legislative history.[3]

Sec. 22 (a) being a "general" definition, the Secretary construed it under the power with which he was invested so to do. The foregoing rule of this Court is specifically applicable.

5. *The Real Issue Presented Here.*

It is respectfully submitted that the instant petition does not express clearly the proposition that the Commissioner is seeking an opportunity to ask this Court to invalidate and declare void a statutory construction with a history well nigh unprecedented in income taxation. It is respectfully submitted that the petition shifts the emphasis from the important principle of statutory construction (controlling in this case) to the secondary (and non-controlling) question of whether the transaction in question is, abstractly, a capital transaction or an income transaction.

It may safely be said that at each term the Commissioner appears several times before this Court and insists

[1] *Koshland* v. *Helvering*, 298 U. S. 441, 447, 446. Cf: *Maryland Casualty Co.* v. *United States*, 251 U. S. 342, 349, 350.

[2] *McFeely* v. *Helvering*, 296 U. S. 102, 108.

[3] *McCaughan* v. *Hershey Chocolate Co.*, 283 U. S. 488, 492.

upon the rule that Departmental Regulations have the force and effect of law; that when such regulations have received repeated application by Departmental Rulings and Decisions, their force and effect becomes tantamount to law; that when the construction put upon a statute by Departmental Regulations, Rulings and Decisions, are repeatedly affirmed by the Board and the Courts, such construction must not be overthrown without the most cogent and weighty reasons; that when such long continued construction and continuous application of that construction has been followed by a reenactment of the statute without change, it thereby receives legislative sanction which gives it the effect of a statutory enactment; and that such construction may not be overthrown if any reason exists to support it.

It may also be safely said that in every business day of the year the Commissioner insists upon the application of this rule in the Department, in the Board, or in some court of this land. It is safe to assert that thousands of cases are decided each year, in the Department, in the Board, and in the Courts, upon the application of this rule.

This Court has repeatedly sustained the Commissioner and has applied constructions put upon the statute by the Department, which have had no such history as the present one. The office of the Commissioner is a unit. Consistency of position should, therefore, be expected of the Commissioner, because it is by the construction and interpretation put upon the statute by his Department that practically all tax controversies are governed, and it is his regulations and rulings which form the guide for all transactions made by taxpayers. If the Commissioner is to contend hereafter that Departmental Regulations are to have the force and effect of law, and that reliance is to be placed upon them by taxpayers and the courts for that reason, such contention would seem to lose much of its weight in light of his present contention that this long continued construction (supported by Board and Court decisions) is null and void and that it has been adminis-

tered and applied for these many years without any reason to support it.

6. *The Money Involved is Not Determinative.*

The petition states that there are six similar cases pending in the Board and at least eighteen in the Bureau. The taxpayer does not have the advantage of statistics but respectfully suggests to the Court the following:

For about 25 years the Commissioner administered this section under his rulings that the instant transactions were capital transactions and not income transactions. For 16 years of that time his Regulations so provided. During about 10 years of that period he maintained and defended that position in the Board of Tax Appeals and in the Courts, in a large number of cases. During that period the statute was repeatedly reenacted without change. Obviously every tax case in which this principle was applied was not made the subject of a published Departmental ruling or Board decision. It is reasonable to suggest, therefore, that his long continued construction has been applied to thousands of cases; that thousands of taxpayers have had their taxes adjusted by the Commissioner under those regulations and rulings; that other thousands of taxpayers made their returns in accordance with those regulations and no tax case arose upon them. The cases of all those thousands of taxpayers are now closed. By applying his construction over this long period of years the Commissioner has unquestionably collected vast amounts of money in taxes.

The Commissioner now seeks to apply retroactively an opposite rule. He seeks to apply such opposite rule retroactively to 1924. That is now a period of 14 years. His petition says there are now about 24 cases. This is an average of slightly less than two cases per year since 1924. It is respectfully submitted that this does not present to this Court a case of great national importance.

The retroactive change of construction contended for

by the Commissioner would violate a long established doctrine of this Court relative to uniformity of taxation. According to the petition herein a very negligible fraction of taxpayers' cases, which have arisen on this point since 1918, are now involved. Practically all of them are finally closed by the statute of limitations. It would be unjust and oppressive to the remaining few to apply a rule totally opposite to, and inconsistent with, the rule applied to practically all the similarly circumstanced taxpayers through all these years of the administration of the section in question.

The rule of this Court is well established that a construction of a statute must not be adopted which leads to unjust, oppressive or inconsistent results, and which does violence to the rule of uniformity of taxation of taxpayers similarly situated. *United States* v. *Kirby*, 7 Wall. 482, 486; *Ilfeld Co.* v. *Hernandez*, 292 U. S. 62, 68; *Savings and Loan Ass'n* v. *Topeka*, 20 Wall. 655, 22 L. ed. 455, 461; *Reagan* v. *Trust Co.*, 154 U. S. 362, 390; *Sioux City Bridge Co.* v. *Dakota County*, 260 U. S. 441 (by Mr. Justice Taft); *Ozawa* v. *United States*, 260 U. S. 178, 194. See also *Taylor* v. *L. & N. R. Co.*, 88 Fed. 350; *Railroad and Telephone Cos.* v. *Board*, 85 Fed. 302, bot. 307; *County of Santa Clara* v. *Railroad Co.*, 18 Fed. 385, 399; *Louisville & N. R. Co.* v. *Bosworth*, 230 Fed. 191, 209; *State* v. *Taylor*, 35 N. J. Law 184; *People ex rel.* v. *City of Chicago*, 152 Ill. 546, 552; *Supervisors* v. *Railroad Co.*, 44 Ill. 229; *Ex parte Bridge Co.*, 62 Ark. 461; *Com'rs of Inland Revenue* v. *Harrison*, L. R. 7 H. L. 1; Lewis' Sutherland Statutory Construction, Vol. 2 (2d Ed. 1904), sec. 489, p. 913.

In *Bingham* v. *United States*, 296 U. S. 211, this Court, quoting with approval from *Lewellyn* v. *Frick*, 268 U. S. 238, said:

> This court applied the rule that acts of Congress are to be construed, if possible, so as to avoid grave doubts as to their constitutionality; and said that such doubts were avoided by construing the

> statute as referring to transactions taking place after it was passed. In that connection we invoked the general principle "that the laws are not to be considered as applying to cases which arose before their passage" when to disregard it would be to impose an unexpected liability that, if known, might have been avoided by those concerned.

And in *United States* v. *Flannery*, 268 U. S. 98, this Court said that: "Decisions affecting the business interests of the country should not be disturbed except for the most cogent reasons." *National Bank* v. *Whitney*, 103 U. S. 99, 102.

The taxpayer respectfully submits that the desire of the Commissioner to invalidate retroactively his Regulations and Rulings of many years standing would result in unjust, oppressive, and inconsistent results and would do violence to the rule of uniformity of taxation; and that the Court below correctly applied the rule applicable to a long continued construction of the statute in light of which the statute was repeatedly reenacted without change.

CONCLUSION.

The petition should be denied for the reasons above stated.

Respectfully submitted,

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September, 1938.

APPENDIX.

Statute and Other Authorities Involved.

Revenue Act of 1928, c. 852, 45 Stat. 791:

> Sec. 22. Gross Income.
>
> (a) *General definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

This provision was enacted in substantially the same language in the Revenue Act of 1913 and was thereafter so reenacted in the Revenue Acts of 1916, 1917, 1918, 1921, 1924, 1926 and 1928. The Revenue Act of 1928 is the controlling act in the instant case. Thereafter it was likewise so reenacted in the Revenue Acts of 1932 and 1934.

Treasury Regulations 74, relating to the Revenue Act of 1928:

> Art. 66. *Sale by corporation of its capital stock.*—The proceeds from the original sale by a corporation of its shares of capital stock, whether such proceeds are in excess of or less than the par value of the stock issued, constitute the capital of the company. If the stock is sold at a premium, the premium is not income. Likewise, if the stock is sold at a discount, the amount of the discount is not a loss deductible from gross income. If, for the purpose of enabling a corporation to secure working capital or for any othery purpose, the shareholders donate or return to the corporation to be resold by it certain shares of stock of the company previously issued to them, or if the corporation purchases any of its stock and holds it as treasury stock, the sale of such stock will be considered a capital transaction and the proceeds of such sale will be treated as capital and will not

constitute income of the corporation. A corporation realizes no gain or loss from the purchase or sale of its own stock. (See article 176.)

The foregoing article is contained in practically identical language in Reg. 45 (1918 Act), Reg. 62 (1921 Act), Reg. 65 (1924 Act), Reg. 69 (1926 Act), Reg. 74 (1928 Act), and Reg. 77 (1932 Act).

Treasury Decision 4430, approved May 2, 1934, XIII-1 Cumulative Bulletin 36:

ARTICLE 66: Sale by corporation of its capital stock. XIII-20-6792 T. D. 4430

(Also Section 23 (i), Article 176.)

INCOME TAX.

Acquisition or disposition by a corporation of its own capital stock.

Articles 543 and 563, Regulations 65 and 69, and articles 66 and 176, Regulations 74 and 77, amended.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER
OF INTERNAL REVENUE,
Washington, D. C.

To Collectors of Internal Revenue and Others Concerned:

Articles 543 of Regulations 65, approved October 6, 1924, and Regulations 69 approved August 28, 1926, and articles 66 of Regulations 74 approved February 15, 1929, and Regulations 77, approved February 10, 1933, are hereby amended to read as follows:

Acquisition or disposition by a corporation of its own capital stock.—Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. The receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be

in excess of, or less than, the par or stated value of such stock.

But where a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. So also if the corporation receives its own stock as consideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property. Any gain derived from such transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of applicable statutes.

Articles 563 of Regulations 65, approved October 6, 1924, and Regulations 69, approved August 28, 1926, are hereby amended by striking out the first and second sentences thereof, by substituting the words "a corporation" in place of the second word in the third sentences of those articles, and by adding the following sentence to those articles:

As to the acquisition or disposition by a corporation of its own capital stock, see article 543.

Article 176 of Regulations 74, approved February 15, 1929, is hereby amended by omitting the first and second sentences thereof, by substituting the words "a corporation" in place of the second word in the third sentence of this article, and by adding the following sentence to this article:

"As to the acquisition or disposition by a corporation of its own capital stock, see article 66."

Article 176 of Regulations 77, approved February 10, 1933, is hereby amended by omitting the first and second sentences thereof, and by adding the following sentence to this article:

"As to the acquisition or disposition by a corporation of its own capital stock, see article 66."

GUY T. HELVERING,
Commissioner of Internal Revenue.

Approved May 2, 1934.

H. MORGENTHAU, JR.,
Secretary of the Treasury.

The logic supporting the principle that these transactions are capital transactions was clearly set forth in 1925 by Judge Learned Hand in *Borg* v. *International Silver Co.*, 11 F. (2d) 147, at p. 150, as follows:

> So we think that the resolution created no presumption that the defendant intended to retire the shares. But, if it did, the presumption would be rebutted by what took place at the time and thereafter. It is clear, from the way in which it treated the shares in 1908 and afterwards, that the defendant did not suppose the shares were retired, or were to be. If so, it would not have carried them as treasury stock for 15 years. We can construe the balance sheets in no other way. The shares should not have appeared in the sheets at all, or, if they did, only as held for retirement. To mark them as held "in treasury" was to ticket them as treasury shares; it could mean nothing else. The original note on the sheet for 1908 does not say anything to the contrary; they were not "outstanding," because they were held by the defendant; to be "outstanding," they must be effective obligations against it.
>
> Against this it is argued that the shares should have been carried among the assets either at cost—as prescribed by the Interstate Commerce Commission—or at par, and that the assets should not have been reduced. The affidavits are not clear as to the most approved way of carrying treasury shares, and anyway we think the issue immaterial. Such shares are of necessity retired in this sense: That they constitute no longer any liability of the defendant. A corporation can have no right of action against itself, as must be if the share is truly a liability.
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> * * * * * * * *
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> To carry the shares as a liability, and as an asset at cost, is certainly a fiction, however admirable. They are not a liability, and on dissolution could not be so treated, because the obligor and obligee are one. They are not a present asset, because, as they stand, the defendant can not collect upon them. What in fact they are is an opportunity to acquire new assets for the corporate treasury by creating new obligations. In order to indicate this potentiality, it may be the best accounting to carry them as an asset at cost, providing,

of course, all other assets are so carried. Even so, a company which revalued its assets might properly carry them at their sale value when the revaluation was made. In any event there can be no ambiguity in stating the facts more directly, as the defendant did; that is, in treating the shares as not in existence while held in the treasury, except as a possible source of assets at some future time, when by sale at once they become liabilities and their proceeds assets. It makes no difference whether this satisfies ideal accounting or not.